

**SOUTH DAKOTA REVOLVING ECONOMIC DEVELOPMENT
AND INITIATIVE FUND
(A Fund of the State of South Dakota)**

AUDIT REPORT

Fiscal Year Ended June 30, 2010

**SOUTH DAKOTA REVOLVING ECONOMIC DEVELOPMENT
AND INITIATIVE FUND
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MARTIN L. GUINDON, CPA
AUDITOR GENERAL

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND
ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF
FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS

The Honorable M. Michael Rounds
Governor of South Dakota

and

South Dakota Board of Economic Development

We have audited the financial statements of the South Dakota Revolving Economic Development and Initiative Fund as of and for the year ended June 30, 2010 and have issued our report thereon dated November 24, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the South Dakota Board of Economic Development's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the South Dakota Board of Economic Development's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the South Dakota Board of Economic Development's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying schedule of findings and responses, we identified a deficiency in internal control over financial reporting that we consider to be a material weakness.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to

prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiency described in the accompanying schedule of findings and responses as finding number 04001201001 to be a material weakness.

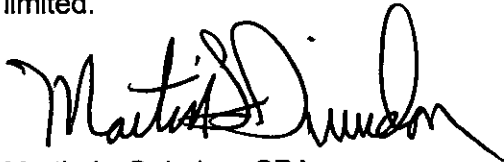
Compliance and Other Matters

As part of obtaining reasonable assurance about whether the South Dakota Revolving Economic Development and Initiative Fund's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

We noted certain matters that we reported to management of the South Dakota Board of Economic Development in a separate letter dated November 24, 2010.

South Dakota Board of Economic Development's response to the finding identified in our audit is described in the accompanying schedule of findings and responses. We did not audit the South Dakota Board of Economic Development's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of management and members of the South Dakota Legislature and is not intended to be and should not be used by anyone other than those specified. However, this report is a matter of public record and its distribution is not limited.

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Martin L. Guindon, CPA
Auditor General

November 24, 2010



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MARTIN L. GUINDON, CPA
AUDITOR GENERAL

INDEPENDENT AUDITOR'S REPORT

The Honorable M. Michael Rounds
Governor of South Dakota

and

South Dakota Board of Economic Development

We have audited the accompanying financial statements of the South Dakota Revolving Economic Development and Initiative Fund, as of and for the fiscal year ended June 30, 2010, as listed in the table of contents. These financial statements are the responsibility of the South Dakota Board of Economic Development's management. Our responsibility is to express an opinion on these financial statements based on our audit.

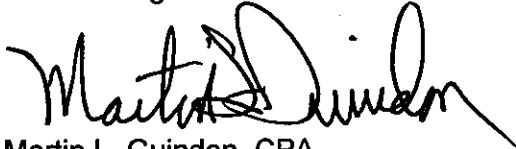
We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

The financial statements present only the financial position and changes in financial position and cash flows of the South Dakota Revolving Economic Development and Initiative Fund. They do not purport to, and do not, present fairly the financial position of the State of South Dakota as of June 30, 2010, and the changes in its financial position and its cash flows, where applicable, for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the South Dakota Revolving Economic Development and Initiative Fund as of June 30, 2010, and the respective changes in financial position and cash flows thereof for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 24, 2010 on our consideration of the South Dakota Revolving Economic Development and Initiative Fund's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations and contracts, and other matters. The

purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

A handwritten signature in black ink, appearing to read "Martin L. Guindon". The signature is stylized with a large, looped "M" and a long, sweeping underline.

Martin L. Guindon, CPA
Auditor General

November 24, 2010

SOUTH DAKOTA REVOLVING ECONOMIC DEVELOPMENT
AND INITIATIVE FUND
STATEMENT OF NET ASSETS
June 30, 2010

ASSETS

Current Assets:

Cash and Cash Equivalents (Note 2C)	\$ 39,563,876
Accounts Receivable - Bankwest	1,162,847
Loan Interest Receivable	94,841
Investment Income Receivable	219,512
Loans Receivable (Net) (Note 2F)	8,188,930
Motor Fuel Tax Refunds Receivable	3,431
Total Current Assets	<u>49,233,437</u>

Noncurrent Assets:

Equipment (Net) (Note 2E)	21,089
Loans Receivable (Net) (Note 2F)	41,031,464
Total Noncurrent Assets	<u>41,052,553</u>

TOTAL ASSETS	<u>90,285,990</u>
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LIABILITIES

Current Liabilities:

Accounts Payable	13,142
Wages Payable	23,525
Grants Payable	42,972
Accrued Leave Liability (Note 5)	11,672
Due to Other Funds	5,382
Total Current Liabilities	<u>96,693</u>

Noncurrent Portion of Accrued Leave Liability (Note 5)	<u>10,455</u>
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TOTAL LIABILITIES	<u>107,148</u>
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NET ASSETS

Investment in Capital Assets	21,089
Unrestricted	90,157,753

TOTAL NET ASSETS	<u>\$ 90,178,842</u>
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The notes to the financial statements are an integral part of this statement.

SOUTH DAKOTA REVOLVING ECONOMIC DEVELOPMENT
AND INITIATIVE FUND
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS
For the Fiscal Year Ended June 30, 2010

Operating Revenue:	
Interest Income on Loans	\$ 1,489,244
Reclamation of Grants	296,076
Other Income	83,288
Total Operating Revenue	<u>1,868,608</u>
Operating Expenses:	
Personal Services and Benefits	144,458
Travel	20,475
Contractual Services	216,991
Supplies and Materials	12,161
Grants and Subsidies	72,704
Depreciation Expense (Note 1)	4,440
Bad Debt Expense	824,463
Total Operating Expense	<u>1,295,692</u>
Operating Income (Loss)	572,916
Nonoperating Revenue (Expense):	
Investment Income	1,696,820
Other Income	141,083
Services Provided to Others (Note 2G)	(245,031)
Total Nonoperating Revenue (Expense)	<u>1,592,872</u>
Change in Net Assets	2,165,788
Beginning Net Assets	<u>88,013,054</u>
End of Year Net Assets	<u>\$ 90,178,842</u>

The notes to the financial statements are an integral part of this statement.

SOUTH DAKOTA REVOLVING ECONOMIC DEVELOPMENT
AND INITIATIVE FUND
STATEMENT OF CASH FLOWS
For the Fiscal Year Ended June 30, 2010

Cash Flows From Operating Activities:		
Receipts for Loan Repayments	\$ 9,139,854	
Payments for Loans Originated	(5,571,041)	
Receipts from Customers and Users	83,288	
Payments for Employee Services and Benefits	(169,085)	
Payments for Interfund Services Used	(55,002)	
Payments to Suppliers and for Claims	(280,506)	
Net Cash Provided (Used) by Operating Activities		3,147,508
Cash Flows From Noncapital Financing Activities:		
Motor Fuel Taxes	143,872	
Services Provided to Others	(245,031)	
Net Cash Provided (Used) by Noncapital Financing Activities		(101,159)
Cash Flows From Investing Activities:		
Pooled Investment Income	1,783,111	
Net Cash Provided by Investing Activities		1,783,111
Net Increase in Cash and Cash Equivalents During the Fiscal Year		4,829,460
Cash and Cash Equivalents at Beginning of Year		34,734,416
Cash and Cash Equivalents at End of Year		<u>\$ 39,563,876</u>
Reconciliation of Operating Income to Net Cash Provided (Used) by Operating Activities:		
Operating Income (Loss)		\$ 572,916
Adjustment to Reconcile Operating Income to Net Cash Provided by Operating Activities		
Depreciation/Amortization Expense	4,440	
Decrease/(Increase) in Assets:		
Loans Receivable	3,646,304	
Loan Interest Receivable	57,552	
Accounts Receivable - Bankwest	(1,146,112)	
Increase/(Decrease) in Liabilities:		
Accounts Payable	(5,547)	
Wages Payable	(1,750)	
Grants Payable	42,972	
Accrued Leave Liability	(22,877)	
Due to Other Funds	(390)	
Total Adjustments		2,574,592
Net Cash Provided (Used) by Operating Activities		<u>\$ 3,147,508</u>

The notes to the financial statements are an integral part of this statement.

**SOUTH DAKOTA REVOLVING ECONOMIC DEVELOPMENT
AND INITIATIVE FUND
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2010**

1. AUTHORIZING LEGISLATION

The South Dakota Revolving Economic Development and Initiative Fund (REDI Fund) was created in 1987 by an act of the South Dakota Legislature. The REDI Fund was established for the purpose of making loans for economic development. The REDI Fund is a fund of the State of South Dakota and is administered by the Governor's Office of Economic Development (GOED).

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Fund Accounting

The REDI Fund is accounted for as an enterprise fund. Enterprise funds are used to account for activities that are financed and operated in a manner similar to private business enterprises. The REDI Fund is a part of the State of South Dakota and, as such, the accompanying financial statements are included in the Comprehensive Annual Financial Report of the State of South Dakota.

B. Basis of Accounting

The REDI Fund follows the accrual basis of accounting. This method of accounting recognizes the financial effect of transactions, events, and interfund activities when they occur, regardless of the timing of related cash flows. Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. Revenues and expenses not meeting this definition, such as investment earnings and services provided to others are reported as nonoperating. The REDI Fund follows all Governmental Accounting Standards Board (GASB) pronouncements and those Financial Accounting Standards Boards Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins that were issued on or before November 30, 1989, except those that conflict with a GASB pronouncement.

C. Cash and Investments

Cash includes cash on hand and a participating interest in the State's internal investment pool held by the State Treasurer and is used for the purposes of reporting cash flows. The amount held in the State's internal investment pool is reported as fair value.

Management of the State's internal investment pool is the statutory responsibility of the South Dakota Investment Council (SDIC). The investment policy and required risk disclosures for the State's internal investment pool are presented in the SDIC's audit report which can be obtained by contacting the Department of Legislative Audit, 427 South Chapelle, c/o 500 East Capitol, Pierre, South Dakota 57501.

D. Value Added Agriculture Subfund Projects

The Board of Economic Development (BED) approves projects funded from the Value Added Agriculture Subfund in the form of loans, grants or loans/grants. For financial reporting purposes, the BED estimates that 10% of the projects financed as loans/grants during the year will be repaid in the form of loans and records this estimate as loans receivable in the financial statements with the balance of the financing reported as a grant expense. Upon project completion, the BED evaluates the feasibility of the project and determines if the funds provided are considered a grant or will be repaid in the form of a loan.

E. Capital Assets

Assets are capitalized based on policies established by the South Dakota Bureau of Finance and Management. Capital assets are capitalized at cost or estimated historical cost, if the original cost is unavailable. Equipment is capitalized when the cost of individual items is \$5,000 or more. Depreciation on capital assets is computed using the straight line method over the estimated useful lives of the assets, which is 3 to 10 years for all assets. When assets are disposed of, the costs and related accumulated depreciation are removed from the accounts and any gain or loss is reflected in the results from operations in the period of disposal.

A summary of changes in capital assets for the year ended June 30, 2010 is as follows:

	<u>Balance 07/01/09</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance 06/30/10</u>
Equipment	\$ 27,599	\$ -0-	\$ -0-	\$ 27,599
Accumulated Depreciation	2,070	4,440	-0-	6,510
Capital Assets, Net	<u>\$ 25,529</u>	<u>\$ 4,440</u>	<u>\$ -0-</u>	<u>\$ 21,089</u>

F. Loans Receivable

Loans receivable at June 30, 2010, is shown net of the allowance for doubtful loans of \$1,820,530.

G. Services Provided to Others

Earnings on the Revolving Economic Development and Initiative Fund and the Value Added Agriculture Subfund may be used for the administrative costs of the Division of Finance of the Governor's Office of Economic Development per SDCL 1-16G-24. Earnings used for the administrative costs of the Division of Finance of the Governor's Office of Economic Development totaled \$245,031 for the year ending June 30, 2010.

3. VALUE ADDED AGRICULTURE SUBFUND ACTIVITY

During the 1999 legislative session the Value Added Agriculture Subfund was created within the REDI Fund. The legislature designated three million dollars from the REDI Fund for the purpose of making grants or loans for value added agricultural products. It also designated three cents per gallon of each motor fuel tax refund on any purchases of motor fuel after July 1, 1999, for the purpose of this fund.

The following is a breakdown of the activity in the subfund for fiscal year 2010 and its corresponding net assets at June 30, 2010:

	Value Added Agriculture SubFund
Beginning Net Assets	\$ 3,015,615
Reclamation of Grants	296,076
Grant Expense	(72,704)
Motor Fuel Tax Refund Income	141,083
Bad Debt Expense	(7,317)
Investment Income	149,252
Ending Net Assets	<u>\$ 3,522,005</u>

4. COMMITMENTS

At June 30, 2010, the REDI Fund has the following commitments:

Value-Added Agriculture projects approved by
the South Dakota Board of Economic
Development but not disbursed at
June 30, 2010 ----- \$ 345,768

REDI Fund loans approved by the South Dakota
Board of Economic Development but not
disbursed at June 30, 2010 ----- \$ 10,560,847

South Dakota Economic Development Finance
Authority for the Agriculture Processing
and Export Loan Program (RECD Intermediary
Relending Program) ----- \$ 325,000

5. ACCRUED LEAVE LIABILITY

Annual leave is earned by all employees. Upon termination, employees are eligible to receive compensation for their accrued annual leave balances. Employees who have been continuously employed by the State of South Dakota for at least seven years prior to the date of their retirement, voluntary resignation or death will receive payment for one-fourth of their accumulated sick leave balance, such payment not to exceed the sum of twelve weeks of employee's annual compensation. The total leave liability of \$22,127 at June 30, 2010 is shown as short and long-term liabilities on the Statement of Net Assets.

	Beginning Balance	Additions	Deletions	Ending Balance	Due Within One Year
Accrued Leave Liability	\$ 45,004	\$ 29,334	\$ 52,211	\$ 22,127	\$ 11,672

6. RETIREMENT PLAN

The GOED participates in the South Dakota Retirement System (SDRS), a cost-sharing, multiple-employer defined benefit pension plan established to provide retirement, disability, and survivor benefits for employees of the State and its political subdivisions. Authority for establishing, administering and amending plan provisions is found in SDCL 3-12. The SDRS issues a publicly available financial report that includes financial statements, footnote disclosures, and required supplementary information. That report may be obtained by writing to the SDRS, P.O. Box 1098, Pierre, SD 57501-1098 or by calling (605) 773-3731.

Employees are required by state statute to contribute 6 percent of their salary to the plan. State statute also requires the employer to contribute an amount equal to the employee's contribution. The right to receive retirement benefits vests after three years of credited service. The GOED's contributions to the SDRS for the fiscal years ended June 30, 2010, 2009, and 2008 were \$19,347, \$19,762, and \$19,583 respectively, equal to the required contributions each year.

7. PUBLIC ENTITY POOL FOR LIABILITY

The GOED is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The GOED is uninsured for property loss. The GOED participates in the various programs administered by the State of South Dakota. These risk management programs are funded through assessments charged to participating entities. The risk management programs include; 1) coverage for risks associated with automobile liability and general tort liability (including public officials' errors and omissions liability, medical malpractice liability, law enforcement liability, and products liability) through the State's Public Entity Pool for Liability Fund, 2) coverage of employee medical claims through the State's health insurance program, 3) coverage for unemployment benefits through the State's Unemployment Insurance Fund, and, 4) coverage for workers' compensation benefits through the State's Workers' Compensation Fund. Financial information relative to the self-insurance funds administered by the State is presented in the State of South Dakota Comprehensive Annual Financial Report.

DEPARTMENT OF TOURISM AND STATE DEVELOPMENT
BOARD OF ECONOMIC DEVELOPMENT

CURRENT AUDIT FINDING AND RECOMMENDATION

Financial Statement Audit Finding:

Finding No. 04001201001:

Controls were not adequate to ensure the accuracy of amounts reported in the financial statements including the identification and correction of reporting errors and omissions.

Analysis:

During fiscal year 2010, the Department of Tourism and State Development did not have adequate controls to ensure that the financial statements for the Revolving Economic Development and Initiative Fund were prepared accurately. Adjustments were posted by the auditor to the financial statements correcting the errors and omissions noted during the audit. Our audit identified significant adjustments in the following accounts:

- Cash and Cash Equivalents
- Short and Long-Term Loans Receivable
- Allowance for Doubtful Loans Receivable
- Investment Interest Receivable
- Bad Debt Expense
- Cash Flows From Investing Activities

Because the Department did not have adequate controls to ensure the accuracy of amounts reported on the financial statements, there existed an increased exposure to inaccurate financial reporting.

RECOMMENDATION:

1. We recommend the Department implement internal control procedures to identify and correct reporting errors and omissions and ensure the accuracy of amounts reported in the financial statements.

Auditee's Corrective Action Plan:

Below is what we are proposing to address our technical finding:

1. Expand the services provided by the CPA firm to include the audit and review of Short-term/Long-term loan receivable worksheet.
2. Implement a review process which includes the review of the Short-term/Long-term loan receivable worksheet by the Finance Manager.
3. Change the timing of the audit to allow for additional review time after information is received from BFM.
4. Implement a review process to analyze allowance for doubtful loans receivable up to the date of the Audit Report.